



BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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12-07-07
04:59 PM

Order Instituting Rulemaking to
Implement the Commission's
Procurement Incentive Framework and
to Examine the Integration of
Greenhouse Gas Emissions Standards
into Procurement Policies.

The California Energy Commission

Rulemaking 06-04-009
(Filed April 13, 2006)

Docket 07-OIIP-01

**SUPPLEMENTAL COMMENTS
OF THE DIVISION OF RATEPAYER ADVOCATES
ON THE REPORT OF THE SOUTH COAST
AIR QUALITY MANAGEMENT DISTRICT**

I. INTRODUCTION

Pursuant to the November 30, 2007 "Administrative Law Judges' Ruling Extending Comment Deadlines and Addressing Procedural Matters," DRA submits these supplemental reply comments regarding the paper "Over a dozen years of RECLAIM Implementation: Key Lessons Learned in California's First Air Pollution Cap-and-Trade Program," prepared by the South Coast Air Quality Management District (SCAQMD) and dated June 2007. (Report) DRA appreciates the opportunity to comment on the Report, which discusses SCAQMD's experience with the Regional Clean air Incentives Market (RECLAIM) program, a multi-industry cap-and-trade program in the South Coast Basin that targets the reduction of sulfur oxides (SOx) and oxides of nitrogen (NOx) emissions by specifying facility-based caps and declining balances of allowable maximum emissions.

II. DISCUSSION

DRA commends SCAQMD for putting together a thoughtful and comprehensive report that describes the rules development process for RECLAIM, its key design features,

the achievements of RECLAIM between 1994 and 2006, the implementation experience, as well as lessons learned for each of these areas. In the following comments, DRA first highlights several points that are relevant to the instant subject of greenhouse gas (GHG) allowance allocation, as well as other general lessons and observations that apply to the ongoing development of a GHG cap-and-trade mechanism for California.

One significant difference between the RECLAIM program and a GHG cap-and-trade program for the California electricity sector is that the RECLAIM program replaced an existing set of rules that established a fixed emission rate for regulated facilities. This has two implications: first, it made it easier to get buy-in from the regulated facilities to support the cap-and-trade approach; second, it was feasible to benchmark the cost effectiveness of the cap-and-trade program against the command-and-control method. Nevertheless, the majority of the lessons learned from the RECLAIM program are still relevant to the GHG cap-and-trade program design.

A. Lessons related to allowance allocation

The RECLAIM program rules allowed facilities to pick a peak production year between 1989 to 1992 for the 1994 baseline. This led to an over-allocation of trading credits in the initial years. The Report recommended using an average production level over a three to five year period as the basis for allocations to avoid this problem.¹

The Report also recommended that administrative allocation of allowances rather than auctioning allocations, or holding back a small amount of available allocations for an auction, to avoid additional administrative burden.² However, the program rules were crafted to avoid giving allocations the status of property rights, such that SCAQMD has the flexibility to reduce, suspend or terminate credits when it deems such actions are necessary.

¹ Over a dozen years of RECLAIM Implementation: Key Lessons Learned in California's First Air Pollution Cap-and-Trade Program," SCAQMD, June 2007, p. I-4-3.

² *Id.*, p. I-4-3

B. General lessons related to the design of a GHG cap-and-trade program

The rule development process for RECLAIM took about two and a half years, with the majority of rules adopted in October 1993, and additional rules adopted in 2001. For the initial set of rules adopted in October 1993, multiple amendments have since been made to each rule (the Trading Requirements rule has been amended seven times, while the General rule has been amended six times.) This illustrates that even a lengthy and careful process for the development of rules cannot anticipate every possible condition and scenario, so that it is important for regulators to reserve the right to amend program rules after the start of the program.

Another lesson is that extensive resources and development time will likely be necessary to implement an information management system to monitor and/or collect emissions data to ensure compliance as well as to provide information access to the public. As the California Public Utilities Commission and California Energy Commission jointly consider the point of regulation for the electricity sector, this point should be considered when determining the merits of a load-based regulatory system. Given that a regional or federal GHG program will likely be source-based, California will have to adapt the information management system when it switches from a load-based scheme to a source-based scheme. This will be a very costly endeavor and can possibly impede California's participation in a region-wide or nation-wide cap-and-trade program in a timely manner.

Program enforcement is another area that should be carefully considered to ensure the success of the program. As pointed out in the Report, "it must be clear to [all regulated parties] what constitutes a violation; how the violation will be enforced; what evidence and presumptions will prove the violation; and what general and tailored penalties will be assessed for a violation."³ As part of the enforcement rule, audit requirements should also be clearly spelled out.

³ *Id.* p. p.III-1-7.

Of note also is the extensive involvement of SCAQMD in the actual trading program. It has been generally assumed that the trading of GHG emission allowances will take place in an industry-developed secondary market, with little oversight required by government. SCAQMD deemed that a market system needs good tracking and transparency of information and those safeguards against fraudulent trades requires regulatory oversight. For the RECLAIM program, SCAQMD assumed the role of sole registrar for credit trades, established the rules and systems to track credit trades and prices and to ensure public access to that information. The Air Resources Board should consider these market issues as it plans for the operation of a GHG cap-and-trade program.

III. CONCLUSION

DRA respectfully requests that the Commission consider and adopt the recommendations in these comments as they relate to the allocation of allowances and to the regulation of GHG emissions more generally.

Respectfully submitted,

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Dated: December 7, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of “**SUPPLEMENTAL COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES ON THE REPORT OF THE SOUTH COAST AIR QUALITY MANAGEMENT DISTRICT**” in **R.06-04-009** and **CEC Docket 07-OIIP-01** by using the following service:

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